bearing the burden sharing the benefits

a report by the
national council of welfare
on taxation
and the distribution of income

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B E A R I N G   T H E   B U R D E N
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INTRODUCTION

Each year Statistics Canada publishes figures on the distribution of income among Canadians. These numbers attract little of the attention paid to the monthly unemployment and inflation figures, but the picture they paint is at least as disturbing. They reveal a society which continues to be marked by vast inequalities of income - inequalities which condemn three million of our citizens to lives of poverty[1] in the midst of Canada's widespread affluence.

The lowest-income twenty percent of Canadians receive barely 4% of the total national income. The highest-income twenty percent, in contrast, receive more than 40% - a share ten times as great. The injustice of such an unequal distribution of income is compounded by the fact that the relative shares have remained virtually unchanged over the quarter century that the government has been gathering such data. In 1951 the bottom fifth of Canadians received 4.4% of the national income and the top fifth got 42.8%.[2] In 1976 the counterpart figures were 3.9% for the group at the bottom and 44.0% for those at the top.[3]

While the respective proportions of total income have remained more or less constant, the income gap separating the richest and poorest twenty percent of Canadians has grown enormously over the past twenty-five years as a result of the multifold increase in national income. In 1951 the gap stood at $3,060 - adjusting for inflation, the equivalent in 1976 dollars of $6,900. By 1976 the difference between the richest and poorest fifths had increased to $18,000. In other words, the gap, expressed in dollars of equal value, had multiplied by over two and a half times.

That the income gap between rich and poor Canadians has grown so dramatically over the same years in which Canada was constructing an elaborate multi-billion dollar income security

system may come as a surprise. However it isn't hard to explain in light of the fact that so much of this welfare system consists of programs providing equal benefits to rich and poor alike. Sending the same family allowance and old age security cheque to a wealthy family and an impoverished one does not, after all, reduce the difference between their respective incomes. It only maintains the gap at the same size. And these 'universal' programs account for more than 80% of all expenditures for the income security programs administered by the federal Health and Welfare department.[4] All of the rhetoric about the welfare state notwithstanding, our welfare system has had little effect in tempering the overwhelmingly unequal income distribution of the market place.

However the income distribution that results from this combined operation of the market place and the welfare system is still not the final distribution. One last mechanism remains for reducing income inequality and altering the distribution of actual spending power among Canadians - the supposedly leveling effects of the tax system.

For most people, the tax system means the personal income tax which is progressively graduated and from which those with the lowest incomes are wholly exempted. This tax represents 40% of all federal and provincial revenues. With rates that begin at 9% (federal and provincial combined) on the first $760 of taxable income and rise in steps to 62% on any taxable income over $91,000,[5] it might be expected that this tax would dramatically change the income shares of the various groups.

In fact, it changes them hardly at all, as the following table for 1975 indicates.[6]

	Share of total income before income tax	Share of total income after income tax	Difference
Bottom 20%	4.0%	4.6%	+ .6%
Second 20%	10.6	11.5	+ .9
Middle 20%	17.6	18.2	+ .6
Fourth 20%	25.1	25.1	0
Top 20%	42.6	40.6	-2.0

The poorest 20% of families and single persons had their after-tax share of total income increased by a mere six-tenths of one percent - from 4.0 to 4.6%. The second 20% actually did better than those at the bottom, seeing an increase in their share of nine-tenths of one percent. The middle 20% gained the same amount as those at the bottom. Only the 20% of family units with the highest incomes saw their share lowered because of personal income tax - and this was limited to 2%. They were still left with almost 41% of total disposable income - nine times the amount available to the lowest-income 20%.

The tax system, of course, includes a great deal more than just personal income tax. There are also federal and provincial sales taxes, corporate income taxes, excise taxes (such as the taxes on liquor and tobacco), import duties and property taxes. Some parts of the tax system are not even designated as taxes, although that is precisely what they are. The most notable 'taxes-under-another-name' are provincial health insurance premiums, contributions to the Canada/Quebec Pension Plan, and premiums for Unemployment Insurance.

The Statistics Canada data on the after-tax distribution of income unfortunately takes none of these 'non-income' taxes into account. Thus it isn't possible to give a precise measure of the effect of the total tax system on redistribution. However the findings of several studies indicate that complete data, were it available, would prove that the very modest redistribution in favor of the poor resulting from the personal income tax is completely undone by the other parts of the tax system.

The best-known Canadian study of the relative tax burdens borne by various income groups was done for the Economic Council of Canada in 1972. It found that

> while government expenditure programs may contribute to the redistribution of income ... the tax system as a whole does nothing to contribute to this goal. Indeed, over the lower portion of the income scale, the system tends to contradict the ability-to-pay principle by taxing the poor at a higher rate than those who are better off. The effect of the few taxes ... that are progressive is completely offset by the remainder of the taxes in the system ...[7]

Federal taxes, the study concluded, were mildly progressive (the percentage of income collected in tax increased as income rose) except for the lowest income group. What progressivity there was resulted from the personal income tax. All other federal taxes were either proportional (they collected the same percentage of income from everyone) or regressive (they levied a heavier burden on the poor than on anyone else).

Provincial taxes, overall, imposed their heaviest burden on the lowest-income group and were basically proportional for all other groups. Personal income tax was the only consistently progressive part of the provincial tax systems. The other parts were either proportional or regressive. Municipal taxes, based primarily on the property tax, were sharply regressive.

The Economic Council's study was based on the tax system as it existed in 1969. However its conclusions are still valid today. Indeed, if anything, the situation of low-income Canadians is worse now than it was in 1969.

A recent study of changes in income distributions between 1961 and 1974 concluded that

> it is very unlikely that tax changes during the 1970's would operate to improve the relative position of the poorest family units at the expense of the richest family units ... (It) is more likely that the share of taxes of the poorest (20%) of family units has increased relative to the share of taxes of the rich. Therefore the relative position of the poor has probably deteriorated ...[8]

The reasons for this conclusion are not complicated. Some taxes which placed their heaviest burdens on upper-income persons - estate taxes, succession duties, and corporate income taxes - have been reduced or eliminated. Also, the 1971 tax reform sharply lowered the top marginal rates in the personal income tax system (before tax reform the highest marginal tax rate was 80%; today the highest rate is 62%[9]). Most importantly, a host of new exemptions and deductions have been introduced into income tax - all provisions which give no benefit whatsoever to those too poor to pay tax, only modest benefits to lower and middle-income persons, and the greatest benefits to those with the highest income.

In November 1976 the National Council of Welfare issued a report discussing there various exemptions and deductions and how they have contributed to thwarting the progressive rate structure which underlies the income tax system. In that report, The Hidden Welfare System, we estimated the cost of just 17 of these tax subsidies (there are more than 60 all told) at $6.4 billion, with the

taxpayer making over $50,000 receiving an average of $4,000 in annual benefits, and the taxpayer with less than $10,000 income receiving less than $500.[10]

Notwithstanding the effects of these exemptions and deductions, the income tax system remains the only part of Canada's tax structure that is at all redistributive from the rich to the poor. While these tax subsidy measures have very substantially undermined the progressive rate structure, they have not done away with it entirely.

The balance of Canada's tax system, however, begins with no progressive rate structure. Rich and poor are assessed the same 12% federal and up to 10% provincial sales tax on their purchases, the same health insurance premiums and payroll tax rates on their very different incomes. Some of these taxes have no effect on income disparities, while others increase the inequalities. But because of their design, none are capable of narrowing the gap between the affluent and the poor.

The purpose of this report is twofold. First, it will look at some of these non-income taxes and examine their income effects. Second it will look at ways in which the tax system can be used to reduce, rather than broaden, income disparities in Canada.

REGRESSIVE TAXATION: MAKING THE POOR PAY MORE

A person's ability to pay tax is clearly dependent on his income. A poor person has virtually no ability to pay - by the very definition of poverty he needs all of his inadequate income just to buy the necessities for survival. As income rises above the poverty line, however, an individual acquires a modest ability to pay tax. The greater the income, the more the ability to pay.

No government in Canada - federal or provincial - would argue against these statements. Indeed, federal finance ministers and provincial treasurers regularly give assurance of the central role which such concepts of equity play in their decisions about taxation. Yet both levels of government impose taxes which directly contradict these basic principles.

Major parts of the Canadian tax system are regressive. They not only take money away from those persons and families most in need of every dollar of their already inadequate incomes, but actually place their heaviest proportional burdens on the poor. The clearest and perhaps most surprising examples are the taxes used to fund social insurance programs - the Canada and Quebec Pension Plans, Unemployment Insurance, and health care.

Canada/Quebec Pension Plan

The Canada/Quebec Pension Plan is financed through a payroll tax. Each employee in Canada must 'contribute' (a curious euphemism for 'pay tax') at a rate of 1.8% of his or her earnings. The first $1,000 of earnings, however, are exempt from the tax and the maximum earnings on which contributions are collected is $10,400.[11] Employers must match the contributions of their employees.

Since the C.P.P. tax is calculated as a constant percentage of earnings, it may appear, at first glance, to be proportional. In fact, the exemption of the first $1,000 might even seem to make the tax slightly progressive. However once the ceiling on contributory earnings is taken into account, the tax is easily seen to be neither progressive nor proportional overall.

The maximum C.P.P. tax - the contribution required from anyone earning $10,400 or more - is $169.20. No matter how much a person's income exceeds $10,400, he still pays only $169.20. Clearly this fixed amount of tax will be a decreasing percentage of income as earnings rise. A worker making $11,000 and one making $22,000, for example, both pay the same $169.20 a year - but this amount is twice as high a proportion of the former's income as of the latter's.

This is only the first part of what makes the C.P.P. tax regressive. The other element is the fact that C.P.P./Q.P.P. contributions are allowed as deductions in calculating income tax. Because of the increasing marginal rates of the progressive income tax, deductions increase in value as a person's income rises. A $100 deduction, for example, provides a tax saving of $25 to a person in a 25% tax bracket, but a $60 saving to a higher-income person in a 60% bracket. To see the real amount of Canada Pension Plan contribution, the tax saving from the deduction must be subtracted from the required contribution. The resulting net C.P.P. contributions are shown in the table on the following page.

The highest C.P.P. tax rate - 1.57% - is borne by persons earning $8,000 a year. The rate declines by two-thirds when earnings reach $20,000, and by nine-tenths when earnings hit $50,000. And this regressivity of the tax rate is but the first injustice of the C.P.P. tax.

Even more amazing is the fact that while the largest net C.P.P. contributions are collected from workers earning $8,000 a

Net Contributions to the Canada Pension Plan for 1978

Earned Income	Required C.P.P. contribution	Tax saving from deduction[12]	Net C.P.P. contribution	Pension entitlement
$ 6,000	$ 90.00	$ 0	$ 90.00	58%
8,000	126.00	0	126.00	77
10,000	162.00	41.99	120.01	96
12,000	169.20	46.29	122.91	100
15,000	169.20	51.17	118.03	100
20,000	169.20	60.91	108.29	100
25,000	169.20	68.22	100.98	100
50,000	169.20	87.71	81.49	100

year, all these workers get in return is a pension credit entitling them to about three-fourths of a full C.P.P. retirement pension. Workers earning $12,000 a year pay $3 less in net contributions and get a credit entitling them to a full C.P.P. pension. Those making more than $12,000 pay progressively decreasing net contributions for the same full pension credit. In fact, while someone earning $8,000 must pay $126 to get his three-quarter pension entitlement, a $50,000-a-year earner pays only $81 to get a full entitlement.

Unemployment Insurance

Like the Canada/Quebec Pension Plan, Unemployment Insurance involves a payroll tax. The tax rate is 1.5% of earnings with an insurable limit of $240 a week.[13] The compulsory payments of Unemployment Insurance tax go under the name of "premiums". Employees are allowed to deduct these premiums in calculating income tax.

The maximum on insurable earnings and the deductability of premiums result in another regressive tax. Everyone earning above the maximum insurable level pays the same amount of tax but, once again, this decreases as a proportion of earnings as income rises, while the deduction goes up in value as a person moves into higher tax brackets. The 1.5% tax rate charged to a minimum-wage worker earning $6,300 a year decreases to a .75% rate for a $25,000-a-year earner.

Incredibly, what low-income workers get for paying at the highest rate is the lowest coverage. An $8,000-a-year earner pays $120 in net Unemployment Insurance premiums to buy coverage which guarantees him $103 a week if he loses his job. A $25,000-a-year earner pays $112 in net premiums to buy coverage worth $160 a week.

Net Contributions to Unemployment Insurance for 1978

Earned Income	Required U.I. contribution	Tax saving from deduction[14]	Net U.I. contribution	Weekly U.I. entitlement
$ 6,000	$ 90.00	$ 0	$ 90.00	$ 76.92
8,000	120.00	0	120.00	102.56
10,000	150.00	38.88	111.12	128.21
12,000	180.00	49.25	130.75	153.85
15,000	187.20	56.61	130.59	160.00
20,000	187.20	67.39	119.81	160.00
25,000	187.20	75.48	111.72	160.00
50,000	187.20	97.04	90.16	160.00

Premiums fund only part of the Unemployment Insurance program. A very large portion is paid for out of general revenues - the money collected from income taxes, sales taxes and the rest. In fact, the financing of Unemployment Insurance was originally designed so that premiums would pay the entire cost of the program only under close-to-full employment conditions. In periods of unusually high unemployment, it was intended that the extra expense should be borne out of revenues collected from progressive taxation so there would be a fairer distribution of the burden.

However reasonable such a financing system may be, Unemployment Insurance is often criticized for not being more 'self-sufficient' - that is, for not involving higher premiums. The bookkeeping fiction of a tidy, separate Unemployment Insurance Fund - and the related notion that there is an economic or moral benefit if the money in this Fund is generated by one form of taxation (premiums) as opposed to another (the income tax) - has numerous proponents. Two years ago the government gave in to their demands and substantially raised the contribution rate.

What that accomplished was to shift the collection of a half-billion dollars of revenues to a regressive payroll tax instead of continuing to raise it through a progressive income tax. What income redistribution occured went in the wrong direction - an increase in the tax burden of poor and middle-income earners, a decrease in that of the rich.

It should not be assumed from these illustrations, however, that regressive financing need be a feature of all social insurance plans. Workmen's Compensation (or Workers' Compensation as it is now known in some provinces), for example, is a social insurance program involving employer levies and general government revenues, with no regressive payroll tax on employees at all. In Sweden, the social insurance programs which have in many ways been the

model for our own are all financed like our Workmen's Compensation. Having the poor pay most to get least is a made-in-Canada added feature.

Health Insurance

Unemployment Insurance and the Canada Pension Plan are federal government programs. But regressive taxation is hardly the exclusive prerogative of this one level of government. Indeed one of the clearest examples of an ill-conceived tax is a provincial levy - health insurance premiums.

Many people may not think of these as taxes; yet they are. A health insurance premium, after all, is a fee charged by a government to pay for a government service - the basic definition of a tax.

Only three provinces - British Columbia, Alberta and Ontario - have chosen to take advantage of this form of taxation. Quebec funds its health insurance program through a payroll tax. All the other provinces fund theirs from the general revenues raised by income, sales and other taxes.

While the provinces which charge premiums provide no-fee or reduced-cost health insurance to their lowest-income families, the eligibility limits are not even equal to the poverty line in medium-sized cities. In Ontario, for example, a family of four must have earnings of less than $8,900 to be exempted from premiums.[15] The poverty line[16] for a four-person family is $9,155 in a city the size of London or Windsor. (In metropolitan Toronto the poverty line is even higher, $9,778). If an Ontario family of four has an income between $8,900 and $9,900 they pay premiums at the rate of $264 a year. Once their income reaches $9,900, they have to pay full premiums of $528 a year - and those premiums stay the same no matter by how much their income exceeds $9,900.

The regressiveness of this premium structure is obvious. A four-member family whose head earns $9,000 a year pays tax at an effective rate of 2.9% for health insurance. If the earnings are $10,000, the tax is 5.3%. But a family of the same size with earnings of $25,000 pays a health insurance tax of only 2.1%. At an income of $50,000 the rate is 1.1% - one-fifth the rate for the $10,000 family.

The situation in Alberta and British Columbia is similar. Although both provinces have lower premiums than Ontario, they also have much lower cut-offs for reduced-cost health insurance. In Quebec, where health insurance contributions are collected through a 1.5% payroll tax which has an exemption for the lowest-income workers, the $235 maximum required from salaried employees earning above $16,500 produces another regressive rate structure. The table below compares the contributions and premiums charged to a four-person family at different income levels in the four provinces.[17]

Earned Income	Quebec	Ontario	Alberta	British Columbia
$ 5,000 or less	$ 0	$ 0	$ 0	$ 22.50
6,000	40.00	0	86.40	112.50
7,000	98.63	0	169.20	225.00
8,000	112.73	0	169.20	225.00
9,000	126.83	264.00	169.20	225.00
10,000	140.78	528.00	169.20	225.00
12,000	169.43	528.00	169.20	225.00

Because a province doesn't charge premiums does not mean that its health insurance program is free. The citizens of Manitoba, Saskatchewan and the Atlantic provinces have to pay for their health

and medical services, but the primary mechanism for payment is the provincial income tax.[18] While provincial tax is between 38.5% and 46% of basic federal tax in the three provinces that charge premiums, it is between 50% and 58% in the six provinces that do not.

However the use of income tax to pay for health insurance creates a far different distribution of the costs than a system of premiums. Because of the progressivity of income tax, costs of health services are apportioned on the basis of ability-to-pay. Lower and moderate-income families are made to bear a much smaller burden than those with higher income.

Take, as an example, the case of a married taxpayer with two dependents aged under 18 and with an annual income of $10,000. In Saskatchewan, this person's 1978 provincial income tax comes to $122; this includes the "built-in" health insurance premiums. In contrast, if this same family were living in Ontario, provincial income tax plus health premiums would total $799.[19] A cursory comparison of Saskatchewan's 53% income tax rate and Ontario's 44% rate could easily lead to the conclusion that Saskatchewan is the more heavily taxed province. However, as these figures show, its lower and moderate-income families are taxed appreciably less when combined taxes are considered.

The alternatives for financing health insurance graphically illustrate a basic point: Governments do have choices in apportioning the tax burden. The objective of equity in taxation can be achieved while still raising the revenues needed to pay for vital programs. But this will only be accomplished if governments are concerned about the impact of their tax policies on different income groups. And beyond merely being concerned, governments must be prepared to use the collecting side of taxation as a positive instrument to accomplish a fairer distribution of income.

COMBINING TAXES AND TRANSFERS

However progressive tax rates may be, the redistributive consequences of the collecting side of taxation are limited to taking proportionately more from those with higher income than from those with middle and lower income. This undeniably can reduce income disparities but it does nothing about the most fundamental problem of the poor: their lack of an adequate income in the first place.

The tax system, however, need not affect the distribution of income only by taking money away. It can also be used to provide benefits to families and individuals. In fact, the tax system can even be made to provide money to persons with incomes so low that they are below the tax-paying threshold.

Paying benefits through the tax system, of course, is hardly a new idea. The existing Income Tax Act is filled with such programs - everything from home-buying grants to assistance for the elderly. However the means that are generally used for delivering the benefits - the exemptions and deductions in the personal income tax - ensure that the largest benefits go to those with the highest income, and that no benefits at all go to those with the lowest income.

The reason, as we've already noted, is that the tax saving from a deduction or exemption depends on an individual's marginal tax rate. The higher the income, the higher the marginal rate - and so the greater the tax saving. Conversely, at an income level so low that an individual is below the tax-paying threshold, a deduction can never provide so much as a penny in benefits.

If the tax system is to provide benefits in such a way that the inequality of after-tax income is decreased, deductions

and exemptions aren't the answer. What has to be used instead are tax credits.

A tax credit simply means an amount of tax which need not be paid. For example, suppose the government wanted to provide $500 in tax relief to each wage-earner in Canada. It could institute a $500 Wage-Earners Tax Credit. Anyone with earned income would calculate his income tax in the usual manner but because of the credit would not have to pay the first $500. If a person's gross tax were $500 or less, the tax credit would reduce the amount he owes (his net tax) to zero. If his gross tax were more than $500, he would get a tax reduction equal to $500.

A tax credit provides the same tax saving to everyone whose gross tax is at least equal to the amount of the credit. However a person whose gross tax is less than the credit will only benefit in the amount of his tax. In our example, someone with a gross tax of $200 would save that amount because of the Wage-Earners Tax Credit but would not get the full $500 in benefits. Naturally someone so poor that his gross tax is zero would get no benefits whatsoever.

While such an arrangement may be reasonable for some kinds of credits, there are other cases where a tax credit ought to provide the same benefit to everyone. To return to the example of the Wage-Earners Tax Credit, low-income workers are most in need of financial assistance. If the objective of the credit were to provide income supplementation to the working poor along with tax relief to all other taxpayers, then the same $500 in benefits should be available to low-income workers as to high-income workers.

The way to do this is to make the tax credit refundable - that is, if gross tax is less than the amount of the credit, the difference is paid (or refunded) to the individual. Suppose we had a $500 Refundable Wage-Earners Tax Credit. Someone whose gross tax

is $200 would have his tax bill reduced to zero. In addition he would receive a cheque from the government for the remaining $300 in benefits.

One further refinement is possible. Government might want to provide greater benefits to low-income people than to those with higher income. The cost of something like the Refundable Wage-Earners Tax Credit would obviously be large. If the objective were only to supplement low wages, then the full benefits should be restricted to persons earning less than, say, $8,000 a year and no benefits at all should be provided to persons making over $13,000. This could be done through a diminishing refundable tax credit - a credit whose value is reduced by some percentage of income beyond a certain level.

The $500 Refundable Wage-Earners Tax Credit, for example, could be cut down by 10¢ for each dollar of income above $8,000 (in other words, a reduction rate of 10% for the part of earnings above $8,000). Someone earning $8,000 or less would receive the full $500 in benefits. A person making $10,000, though, would only get a credit of $300 ($500 less 10% of the part of his income over $8,000, or $200). At an income level of $13,000 the tax credit would be reduced to zero.

Refundable tax credits already exist in the provincial tax plans of British Columbia, Alberta, Manitoba and Ontario. In Manitoba, for example, the combination of a Property Tax Credit (designed to reduce the impact of property taxes for homeowners and renters) and a Cost-of-Living Tax Credit (intended to rebate a portion of provincial sales tax) provides benefits of between $225 and $529 a year to a family of four. Because the credits are diminishing, the greatest benefits go to low and moderate-income families. For the 1977 tax year, a Manitoba earner supporting his or her family of a spouse and two children on a minimum-wage income ($6,100) received a refund of the full $529. With an income of

$10,000, provincial tax of $395 was reduced to zero, and the amount of the refund was $43.

The provincial refundable tax credit plans are the first step towards using the tax system to provide financial benefits to low-income individuals and families. These plans show that transfer programs can be combined simply and efficiently into the tax system. Rather than be a burden on the poor, the tax system can be used to relieve them of their poverty.

INCOME TAX AND INCOME SUPPLEMENTATION

The starting point for a system of refundable tax credits in the federal income tax system should be an income supplementation program for the working poor. Such a program would herald a significant breakthrough in using the tax system to reduce the income disparity between rich and poor Canadians. It would, at the same time, begin to set straight the single greatest failure of Canada's existing income security system: its denial of assistance to this country's more than half million working poor families.

In spite of repeated proclamations of the virtue of work and the vice of relying on public transfer programs, our society now turns its back on those Canadians who do work but whose incomes are insufficient for their family's needs. Even if welfare assistance exceeds earnings from a job, there are virtually no provisions anywhere in Canada for making up the difference. A family's only choice is to continue subsisting on the lesser income or to become totally reliant on welfare. Except for family allowances, the working poor are generally excluded from all benefits as long as they continue to work.

Five years ago the federal and provincial governments jointly set out to remedy this absurd and unjust situation. A comprehensive review of Canada's social security system was launched with the prime objective of instituting a supplementation program for the working poor.

The social security review has now ended, its prime objective unmet. A federal offer for a modest income supplementation plan to be cost-shared between the federal and provincial governments but operated by the provinces never moved beyond the realm of proposal. It fell victim to jurisdictional disputes, the downturn of the economy, and the tide of expenditure restraint.

However, the need for a supplementation program remains as urgent as ever. And it is possible to introduce such a program immediately with no rise in government expenditures and no overall tax increase. What is required is the restructuring and merging of one part of the income security system, family allowances, with two parts of the income tax system, the dependents' exemption and the children's credit.

Although the latter two are rarely recognized as such, all three of these programs are income support schemes for families with children. The family allowance provides a taxable benefit of $25.68 a month ($308.16 a year) for each child aged under 18. The dependents' exemption excludes from income tax $460 for each dependent child under 16 and $840 for dependents 16 or over. The children's credit allows a reduction in federal income tax of up to $50 for each child.

While they are all programs of the federal government, these three income support programs operate at bewildering cross-purposes. The family allowance, being taxable, provides its greatest benefits to low-income families. The dependents' exemption, on the other hand, provides no benefits at all to low-income families and the greatest benefits to the highest-income families. The children's credit excludes both low-income and high-income families from benefits and provides the greatest tax saving to those in the middle.

However the combined operation of the three programs, as the table on the following page shows,[20] is another dismal pattern of benefits that increase with income. A family with two children and a poverty income of $7,000 or less a year receives $616. A family of the same size but with an income of $25,000 gets close to $1,000.

The cost to Canadian taxpayers of this upside-down income support system is enormous. Family allowances alone cost $2,226

Canada's Three Income Support Programs for Dependent Children in 1978

Earned Income	Net family allowance	Tax saving from exemption	Tax saving from children's credit	Total benefit
$ 7,000 or less	$ 616.32	$ 0	$ 0	$ 616.32
8,000	616.32	266.80	0	883.12
10,000	456.57	340.37	100.00	896.94
15,000	429.95	393.12	100.00	923.07
20,000	401.31	461.14	100.00	962.45
25,000	383.35	491.40	100.00	974.75
50,000	296.83	673.92	0	970.75

(Benefits for an Ontario family of four with one child aged 12 and another aged 16)

million in the present year. A substantial portion of this, about $584 million, will be recovered because the allowances are taxable, but this still leaves a net cost of $1,642 million.[21] The dependents' exemption costs an additional $880 million in lost tax revenue[22] and the children's credit adds a further $275 million to the total.[23] Altogether we are spending $2.8 billion, but in such a manner that low-income families with the greatest need receive the smallest benefits, and highest-income families with least need get the most.

This situation must not be allowed to continue. The three income support programs for children should be replaced by one diminishing refundable tax credit. The benefits from this credit should stand the existing schedule precisely on its head: $500 per child to families with incomes at the bottom of the income scale, $300 per child to families with incomes at the top of the scale.

By properly selecting the income level at which the refundable credit begins to be diminished, and by choosing a suitable reduction rate, full benefits can be assured to all families living below the poverty line. Moreover there need be no decrease in the benefits received by any family whose income is below the median - about $19,500 this year[24] - in comparison to what such a family now gets from the existing three programs.

A refundable tax credit built into the federal income tax system would be nationwide in scope, ensuring the same benefits to families in Newfoundland as in Ontario. Since there is a far greater proportion of low-income families in such economically disadvantaged regions as Atlantic Canada, a refundable credit would also contribute towards reducing regional disparities.

A tax credit would be simple to administer, and would require no new bureaucracy. The minimum credit of $300 a year

could be delivered like the existing family allowances through monthly cheques of $25 per child. The 'diminishing $200' part of the credit would be claimed at income tax time through the completion of a simple schedule added to the tax form.

While the $500 refundable tax credit would not eliminate poverty in Canada, it would be a start at reducing both its extent and its severity. The extra $200 per child over current family allowance levels would mean a $400 income boost for an average size low-income family, more than that for larger families. For some it would be enough to lift them over the poverty line; for most it would at least reduce how far below that line they are.

And it would involve no increase in government spending, no increase in tax rates, and no increase in government deficits.

FOOTNOTES

1. Derived from data in Statistics Canada, Income Distributions by Size in Canada, Preliminary Estimates, 1976, Catalogue No. 13-206 Annual (Ottawa: Publishing Centre, Supply and Services Canada; 1977), page 16.

2. Dominion Bureau of Statistics (now Statistics Canada), Incomes of Non-Farm Families and Individuals in Canada, Selected Years 1951-65, Catalogue No. 13-529 Occasional (Ottawa: The Queen's Printer, 1969), page 78.

3. Statistics Canada, "Quintile Data, Preliminary Estimates, 1976" (Mimeographed page; based on preliminary data from the 1977 Survey of Consumer Finances).

4. Income security programs administered by Health and Welfare Canada are Family Allowances, Old Age Security payments, the Guaranteed Income Supplement, and Spouses' Allowances; of these, the first two are universal and the latter two income-tested.

5. Combined federal and provincial marginal tax rates vary by province and depend on the percentage of basic federal tax used in calculating provincial tax; figures used here and elsewhere in this report apply to Ontario.

6. Statistics Canada, Income After Tax, Distributions By Size in Canada, 1975, Catalogue No. 13-210 Annual (Ottawa: Publishing Centre, Supply and Services Canada; 1977), page 12.

7. Allan M. Maslove, The Pattern of Taxation in Canada (Ottawa: Information Canada, 1973), page 64.

8. W. Irwin Gillespie, "On the Redistribution of Income in Canada", The Canadian Tax Journal, Vol. XXIV, No. 4 (July-August 1976), page 434.

9. See footnote 5.

10. National Council of Welfare, The Hidden Welfare System (Ottawa: 1977), pages 16 and 17.

11. Maximum pensionable earnings and the amount of the exemption are adjusted annually; figures cited are for 1978.

12. In this table and all other income tax calculations in this report the following assumptions are made, unless specifically noted otherwise: Taxpayers are aged under 65; have a spouse,

one child aged 12 and one child aged 16; and pay provincial tax according to the Ontario rate. All family income is from earnings and is received by the taxpayer alone. Family allowance payments, at 1978 rates, are added to earned income in calculating tax liability. In addition to the allowable personal exemptions, the unemployment expense deduction of 3% of wage and salary income to a maximum of $250 and C.P.P./Q.P.P. and U.I. contributions, calculated at 1978 rates, are deducted in computing tax. Taxpayers take the optional standard deduction of $100. No account is taken of other potential deductions such as child care expenses, contributions to private pension plans or the pension income deduction. Calculations are based on 1978 tax rates and take into account the 1978 federal tax credit of 9% of basic federal tax (minimum $300, maximum $500) plus the child credit of $50 per dependent child under age 18 (overall maximum of $500 for tax cut and child credit).

13. Maximum insurable earnings are adjusted annually; figure cited is for 1978.

14. See footnote 12.

15. Under changes announced in the March provincial budget and effective on May 1, the Ontario Health Insurance Plan exempts couples and families from premiums if taxable income is under $3,000 per year; O.H.I.P. charges reduced premiums of $264 if taxable income is between $3,000 and $4,000. Based on the assumptions of footnote 12, a family of four with earnings of $8,869 would have a taxable income of $3,000; at earnings of $9,903, taxable income reaches $4,000. In this report Ontario health premiums are calculated according to the monthly rates announced in the March budget taken on an annual basis.

16. Poverty lines for 1977 were calculated by the National Council of Welfare on the basis of Statistics Canada's 1976 Revised Low-Income Cut-Offs adjusted for an 8.0% increase in the average annual Consumer Price Index from 1976 to 1977. For 1976 cut-offs, see Statistics Canada, <u>Income Distributions by Size in Canada, Preliminary Estimates, 1976</u>, page 6.

17. In Alberta, families are exempt from premiums if taxable income is nil; they pay at a reduced rate of $86.40 if taxable income is between $1 and $1,000. In British Columbia families of three or more pay $22.50 a year if taxable income is nil; they pay at a reduced rate of $112.50 if taxable income is between $1 and $1,000. Under the assumptions of footnote 12, the limit for nil taxable income is $5,683 and for $1,000 taxable income $6,752. See also footnote 15. In Quebec, health premiums are set at 1.5% of an individual's net income for the year (the latter as defined in Quebec income tax), to a maximum of $235

for salaried employees and $375 for self-employed persons. However if the net income of a married taxpayer is less than $5,600, contributions are waived; if net income is between $5,600 and $5,700, contributions are at a reduced rate.

18. Some provinces have come up with names for their general sales taxes which suggest that these levies are used to pay for health services. In Nova Scotia, for example, the sales tax is called a Health Services Tax. In reality this is little more than using names to make a tax more palatable. Sales tax revenues go into the general provincial treasury; some of these dollars may be used to pay for health services, but they may equally be used to pay for any other government program.

19. Provincial tax reductions for 1978 (already announced in both provinces) are included in the totals. However provincial tax credits are _not_ included because 1) these credits are not part of the income tax system _per se_, being related instead to provincial property and/or sales taxes; and 2) calculation of credits would require an estimate of shelter costs but there is no obviously 'typical' rent for a $10,000-a-year family. If we were to assume rent payments of $250 per month and subtract the resulting credits from the sum of provincial income tax and health insurance premiums, provincial tax totals for the $10,000-a-year family would be $122 in Saskatchewan and $582 in Ontario.

20. See footnote 12.

21. Estimates obtained from Health and Welfare Canada.

22. Estimates calculated by the National Council of Welfare. In _The Hidden Welfare System_ federal tax losses in 1974 from the exemption were estimated at $619 million. The exemption in the 1978 tax year is 43% greater than in 1974 because of tax indexing. It has therefore been estimated that the 1978 tax loss will be comparably greater.

23. Canada, Department of Finance, _Supplementary Budget Papers_ (March 31, 1977), page 4.

24. Median income for families with children in 1976 was approximately $17,000 (see Statistics Canada, _Income Distributions by Size in Canada, Preliminary Estimates, 1976_, page 12). Allowing for a 15% inflation rate between 1976 and 1978 brings the projected 1978 median to $19,500.

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